

PRACTITIONERS' CORNER

India's Dispute Resolution Panel Offers Timely Relief For Taxpayers

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With more than 1,400 income tax disputes of foreign companies pending before income tax appellate authorities and total revenue of INR 73 billion at stake,¹ there has been a growing concern among foreign investors regarding the uncertainty and inordinate delays involved in the dispute resolution mechanism in India.

The tax dispute redressal mechanism in India is time-consuming, and finality in high-demand tax litigation is attained only at the higher levels of the litigation process. In the wake of such concerns and with the understanding that the flow of foreign investment is extremely sensitive to prolonged uncertainty in tax-related matters, the Finance Act 2009 created the Dispute Resolution Panel (DRP).

The DRP has been recently commissioned by the government of India as a specialized panel operating from eight cities across India for resolution of transfer pricing disputes and determining the tax liabilities of foreign companies in India.² The tax dispute resolution mechanism in India has been strategically designed to address the grievances of taxpayers.

¹See "Nearly 1,400 tax disputes of global firms are pending: govt.," *The Financial Express*, Dec. 15, 2009 (available at <http://www.financialexpress.com/news/nearly-1-400-tax-disputes-of-global-firms-are-pending-govt/554489/>).

²Notification No. 84/2009, dated Nov. 20, 2009.

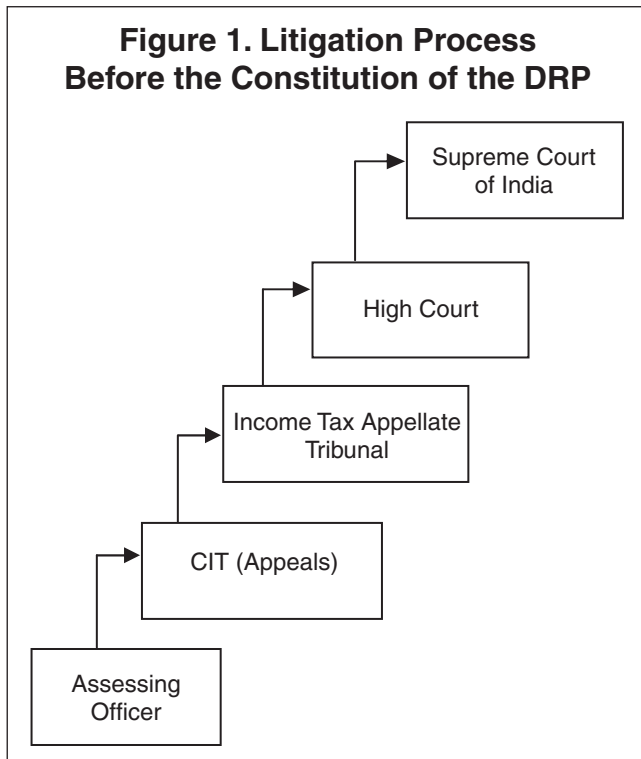
Background

Figure 1 represents the standard litigation process to be followed by a foreign company in India before the constitution of the DRP. At the first stage of the litigation process, adjudication is in the hands of administrative authorities, that is, the Commissioner of Income Tax (Appeals) (CIT(A)), who have a lot of ground-level practical experience. Once a taxpayer moves up the litigation process, the appellate proceedings become more judicial in nature.

In this background it is essential to deliberate the rationale behind empowering the CIT(A), as an administrative authority and a member of the tax department, to play such a crucial role in the appellate proceedings under the Income Tax Act, 1961. The Law Commission, while discussing its role, had as far back as 1958 wisely questioned the impartiality and the effectiveness of the administrative authorities playing such an important role. However, they were countered with hard facts that showed that over 90 percent of appeals from the CIT(A) were upheld by the tribunal, thus showcasing the effectiveness of the office of tax commissioners for appeals.

Unfortunately, current facts show a contrary picture. Over 90 percent of the appeals from the CIT(A) are reversed by the Income Tax Appellate Tribunal (ITAT) (which is a quasi-judicial body), thus once again casting doubt on the competence of the office of CIT(A). It is common understanding now that the lower levels

Figure 1. Litigation Process Before the Constitution of the DRP



of the tax department have an adversarial and aggressive attitude toward taxpayers, resulting in uncertainty and inequity for taxpayers.

Another important factor to be blamed for the ever-increasing number of appeals to the tribunal is the vast discretion of the tax commissioners, who are the sole authorities adjudicating tax assessment disputes at the first level.

To deal with these issues that prevent foreign companies from getting timely justice, more so at the lower stage of the appellate proceedings, the DRP was conceptualized.

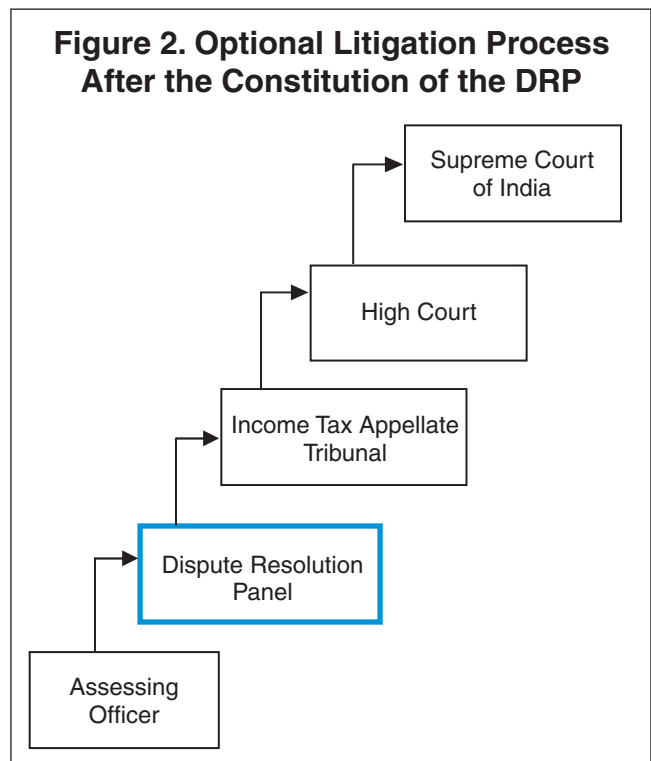
The government seems to have drawn inspiration from the success of the Authority of Advance Rulings (AAR), which determines tax liability in transactions involving nonresidents. The AAR was created in 1993 to provide certainty and predictability to nonresidents for transactions undertaken or proposed to be undertaken, and in the past decade it has provided a lot of comfort to nonresidents undertaking business in India.³ The DRP is similarly aimed at providing certainty to taxpayers regarding their tax liabilities in India.

³For more information on the AAR, see Harshal Shah and Bijal Ajinkya, "The Rising Popularity of Advance Rulings in India," *Tax Notes Int'l*, July 20, 2009, p. 219, Doc 2009-13676, or 2009 WTD 136-9.

Dispute Resolution Panel

The DRP has been introduced to act as an alternate forum to facilitate the judicious and speedy dispute resolution in tax-related matters. Indian law provides that if an assessing officer makes adjustments to a taxpayer's tax returns in a manner prejudicial to the taxpayer, the draft order will be provided to the taxpayer. At this stage, the law gives an option to the eligible taxpayer to either opt for the standard litigation process as depicted in Figure 1 or file an appeal before the DRP as depicted in Figure 2.⁴ If the eligible taxpayer opts for the latter, the DRP would decide the validity of adjustments made by the assessing officer after considering the evidence furnished and objections raised by the taxpayer to issue appropriate directions. These directions are binding on the assessing officer; however, the taxpayer is permitted to appeal against the directions of the DRP. The entire process is time bound and must be completed in nine months from the time an application has been made to the DRP.⁵ Figure 2 represents the litigation process if the taxpayer opts to file an appeal before the DRP.

Figure 2. Optional Litigation Process After the Constitution of the DRP



⁴Clarification regarding "Filing of Objections Before Dispute Resolution Panel," issued by the Central Board of Direct Taxes, dated Jan. 20, 2010.

⁵Section 144C of the ITA, 1961.

An important feature of the DRP is that the panel is composed of three tax commissioners who are not associated with the assessment of the taxpayers. Consequently, the DRP is expected to be an impartial and independent adjudicating body and to have a more reasoned approach.

Relief for Foreign Investors

The DRP is expected to provide great relief to the foreign investors and foreign companies operating in India. The DRP has been designed to address the prime concerns of the foreign investors and multinationals having businesses in India.

The DRP will function as a bench, and therefore, the directions issued to the assessing officer are expected to be based on discussions and deliberations, devoid of prejudices, and thus more reasoned.

Since an aggrieved taxpayer would be allowed to give additional evidence and examine witnesses pertinent to the adverse assessment order, it is expected that disputes would be settled at the first appellate stage, instead of run-ups through the ITAT to the Supreme Court.

A major point of relief for the foreign investors is that the directions of the DRP are binding on the assessing officer, and therefore, the income tax department is not permitted to appeal against the same. Nonetheless, a taxpayer, aggrieved by directions of the

DRP, may approach the ITAT. This is a radical change from the position that existed before the constitution of the DRP, wherein the income tax department was empowered to appeal against any order passed by the CIT(A). This is a welcome change because it is expected to give certainty to foreign companies about their tax liability in India even at the lower stage of the appellate proceedings and at the same time give them an option to appeal in the event of an adverse order.

Because of the adversarial approach adopted by the administrative authorities at the lower stages of the litigation process, foreign taxpayers were exposed to an early tax demand, without being given an opportunity to properly represent their case. In a welcome change, the DRP provisions exempt taxpayers from such onerous obligations by introducing a concept of a "draft assessment order." This move is a step in the right direction, and the foreign companies are likely to breathe a sigh of relief.

Conclusion

The DRP has been introduced with much fanfare and is riding high on the expectations of various stakeholders. The DRP has the crucial task of bringing about consistency in the interpretation and application of legal principles. It is expected that the DRP will bring about much-needed consistency, reason, and certainty to the dispute resolution system and provide timely relief to harrowed taxpayers. ◆